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HOW TO MAKE BETTER DECISIONS

In today's environment of rapid change, there is a premium on making correct decisions quicker and earlier than ever before. This is because the obsolescence cycle, which once spanned generations, is now less than five years in duration and becoming shorter. Lead time, as well as the time available in which to correct mistakes, is almost nonexistent today. Understanding how we make decisions and how we could improve that process could enable us to become both better managers *and* better advisors to our clients.

It is generally assumed that the soundness of a decision reflects the quantity and quality of information on hand at the time the decision is made. Yet even when there is plenty of good information available, mistakes and errors of judgment still occur. This is because people tend to rely on means other than a scientific approach to reach a decision.

A typical manager (or partner, to illustrate our example) may engage in a different activity every nine minutes and may make hundreds of decisions a day. Using the scientific approach of 1) defining the problem, 2) identifying the criteria, 3) weighing the criteria, 4) generating alternatives, 5) rating the alternatives on each criterion, and 6) determining the optimal decision would not be practical (or even possible) in many instances because of time and resource constraints.

Behaviorists refer to these constraints as "bounded rationality"—natural limitations on what one can know and do. In order to cope, people developed a whole range of mechanisms, over the years, that drive the way we make decisions today.

Chief among these mechanisms is our propensity to select the first acceptable or reasonable choice and go with that, whether it is the best choice or not. In other words, we seek to suffice rather than optimize. To assist us in sufficing, we apply various decision rules, referred to by behaviorists as heuristics. These can be useful in arriving at quick decisions when used appropriately. They can also be applied inappropriately and create the risk of systematically leading to a wrong decision. When this occurs, the decision rule becomes a bias, resulting in decisions that on later inspection appear irrational.

Following are three common heuristics that create biases and ultimately lead to critical management mistakes.

The availability heuristic refers to our tendency to give added weight to those things we can easily recall from memory. Biases emanating from this heuristic include 1) the more vivid an event is, the more important it appears to be, 2) the easier it is to remember something, the more numerous it appears to be, and 3) associating coincidences, even though no relationship actually exists.

Examples in the firm include the recent client complaint that becomes a "cause celebre" and suddenly appears to be happening all the time. Instead of dealing with the problem rationally, that is, finding out exactly what happened and how often, the firm develops new rules and operating procedures, etc., to deal with a perceived problem that may be symptomatic of an entirely different problem or not even exist at all. Five years hence, everyone wonders

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where the strange rules originated.

The representative heuristic refers to our tendency to predict probabilities of future performances on their perceived similarities with past experience. Biases emanating from this heuristic include 1) prejudices, whereby individuals assign stereotypes to people or events based on past similar experiences, even though they are not related, 2) relying on descriptive information rather than statistical data, and 3) misapplying statistical theory by drawing conclusions derived from invalid or inappropriate samples, linking independent events, or assigning incorrect probabilities to a sequence of events.

Examples of this bias within firms include preconceived prejudices toward certain types of clients or industries that lead to missed opportunities. Ignoring the facts of a situation and going along with impressions or previous solutions is also common.

The anchoring heuristic refers to our tendency to insufficiently adjust from some initial given point of reference. Biases emanating from this heuristic include 1) fixating on a given value or number even though that value or number is totally erroneous, 2) overconfidence—the tendency to overvalue one's judgment on moderate to difficult questions, 3) the confirmation trap—the tendency to exclude information that contradicts one's belief or position and, 4) hindsight—the tendency to overestimate the degree to which one would have performed given all the facts and knowing the actual outcome.

An example of the anchoring bias in a CPA firm would be the partner who has strong opinions on running other departments even though he has little firsthand knowledge or experience in those situations. Second-guessing (hindsight) is another prevalent disease in professional firms. One can never say for certain how one would have acted in a given situation once the outcome is known. This is because the element of uncertainty (a key factor in making a choice) that always exists at the time of a decision is now totally absent.

Suggestions for Improving Your Decision-Making Performance

- ☐ Don't guess at probabilities or overall numbers and avoid relying just on memory. Instead, obtain definitive counts and objective statistical data.
- ☐ Be wary of descriptive terms such as "impressive" or "disastrous." Check whether the underlying facts substantiate the description.
- ☐ Be cautious in unfamiliar surroundings and avoid "jumping in" before you understand all the issues.
- ☐ Obtain hard dollar values and anticipated dollar outcomes for different alternatives, and then equalize them for timing differences when making comparisons.
- ☐ Set your limits in advance and stick with them. Remind yourself of the added costs involved in continuing a course of action, and actively determine why you should do so.

Other constraints to decision making

Framing describes the way we look at problems and opportunities and create boundaries, reference points, and yardsticks to help us reach decisions and conclusions. It explains how even subtle differences in the way information is provided can substantially change the final choices.

For example, individuals can be influenced by whether choices are expressed in a negative or positive manner. Most people want to avoid losses and seek gains. Therefore, if a situation is framed negatively—"Think of what you will lose"—someone might shun that choice, even if the negative frame and surrounding data are incorrect. The converse is also true.

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Highlights of Recent Pronouncements

FASB Technical Bulletin

No. 94-1 (April 1994), *Application of Statement 115 to Debt Securities Restructured in a Troubled Debt Restructuring*

- ☐ Clarifies that FASB Statement no. 115, *Accounting for Certain Investments in Debt and Equity Securities*, applies to a loan that was restructured in a troubled debt restructuring involving a modification of terms if the restructured loan meets the FASB Statement no. 115 definition of a security.
- ☐ Effective for financial statements issued after April 30, 1994.

GASB Statements of the Governmental Accounting Standards Board

No. 24 (June 1994), *Accounting and Financial Reporting for Certain Grants and Other Financial Assistance*

- ☐ Establishes accounting and financial reporting standards for pass-through grants, food stamps, and on-behalf payments for fringe benefits and salaries.
- ☐ Amends paragraph 8 of National Council on Governmental Accounting (NCGA) Statement 2, *Grant, Entitlement, and Shared Revenue Accounting by State and Local Governments.*
- ☐ Requires:
  1) State governments to recognize their distributions of food stamp benefits as revenue and expenditures in the general fund or a special revenue fund, whether the state government distributes the benefits directly or through agents and whether the benefits are in paper or electronic form;
  2) Employer governments to recognize revenue and expenditures or expenses for on-behalf payments;
  3) Governmental entities that make on-behalf payments for fringe benefits and salaries to classify those payments in the same manner that they classify similar cash grants to other entities.
- ☐ Effective for financial statements for periods beginning after June 15, 1995. Earlier application is encouraged.

No. 23 (December 1993), *Accounting and Financial Reporting for Refundings of Debt Reported by Proprietary Activities*

- ☐ Supersedes paragraphs 13 and 14 of National Council on Governmental Accounting (NCGA) Interpretation 9, *Certain Fund Classifications and Balance Sheet Accounts*, as amended by GASB Statement no. 7, *Advance Refundings Resulting in Defeasance of Debt*.
- ☐ Establishes standards of accounting and financial reporting for current refundings and advance refundings resulting in defeasance of debt reported by proprietary activities—that is, proprietary funds and other governmental entities that use proprietary fund accounting.
- ☐ Requires, for current refundings and advance refundings resulting in defeasance of debt reported by proprietary activities, that the difference between the acquisition price and the net carrying amount of the old debt be deferred and amortized as a component of interest expense in a systematic and rational manner over the remaining life of the old debt or the life of the new debt, whichever is shorter.
- ☐ Effective for financial statements issued for periods beginning after June 15, 1994. Earlier application is encouraged.

No. 22 (December 1993), *Accounting for Taxpayer-Assessed Tax Revenues in Governmental Funds*

- ☐ Amends:
  1) Paragraph 67 of NCGA Statement 1, *Governmental Accounting and Financial Reporting Principles*;
  2) The AICPA's 1974 Industry Audit Guide *Audits of State and Local Governmental Units*;
  3) Statement of Position (SOP) 75-3, *Accrual of Revenues and Expenditures by State and Local Governmental Units*.
- ☐ Requires revenue from taxpayer-assessed taxes, such as sales and income taxes, net of estimated refunds, to be recognized in governmental funds in the accounting period in which they become susceptible to accrual—that is, when they become both *measurable* and *available* to finance expenditures of the fiscal period.
- ☐ Effective for financial statements for periods beginning after June 15, 1994. Earlier application is encouraged.

Statements of Position

No. 94-1 (April 1994), *Inquiries of State Insurance Regulators*

- ☐ Amends chapter 2, "Audit Considerations," of the AICPA Audit and Accounting Guide *Audits of Property and Liability Insurance Companies*.

☐ Amends chapter 9, "Auditing Procedures," of the AICPA Industry Audit Guide *Audits of Stock Life Insurance Companies.*
☐ Addresses the auditor's consideration of regulatory examinations as a source of evidential matter in conducting an audit of an insurance enterprise's financial statements and the auditor's evaluation of material permitted statutory accounting practices applied by insurance enterprises.
☐ Applies to audits of financial statements of life insurance enterprises, property and casualty insurance enterprises, title insurance enterprises, mortgage guaranty insurance enterprises, assessment enterprises, fraternal benefit societies, reciprocal or interinsurance exchanges, pools other than public-entity risk pools, syndicates, and captive insurance companies.
☐ Effective for audits of financial statements for periods ending on or after December 15, 1994.

No. 93-8 (December 1993), *The Auditor's Consideration of Regulatory Risk-Based Capital for Life Insurance Enterprises*
☐ Amends AICPA Industry Audit Guide *Audits of Stock Life Insurance Companies*.
☐ Addresses the auditor's responsibility that arises from the risk-based capital requirements imposed on life insurance enterprises.
☐ Effective for audits of life insurance enterprises' financial statements for periods ending after December 15, 1993.

No. 93-7 (December 1993), *Reporting on Advertising Costs*
☐ Provides guidance on financial reporting on advertising costs in annual financial statements.
☐ Requires:
1) Reporting the costs of all advertising as expenses in the periods in which those costs are incurred, or the first time the advertising takes place, except for direct-response advertising *(a)* whose primary purpose is to elicit sales to customers who could be shown to have responded specifically to the advertising and *(b)* that results in probable future economic benefits (future benefits);
2) Reporting the costs of direct-response advertising *(a)* whose primary purpose is to elicit sales to customers who could be shown to have responded specifically to the advertising and *(b)* that results in probable future benefits as assets;
3) Amortizing the amounts of direct-response advertising reported as assets, on a cost-pool-by-cost-pool basis, over the estimated period of the benefits;
4) Disclosure of certain information.

☐ Amends Statements of Position:
1) 88-1, *Accounting for Developmental and Preoperating Costs, Purchases and Exchanges of Take-off and Landing Slots, and Airframe Modifications*, paragraph 22;
2) 89-5, *Financial Accounting and Reporting by Providers of Prepaid Health Care Services*, paragraph 54;
3) 90-8, *Financial Accounting and Reporting by Continuing Care Retirement Communities*, paragraph 15.

☐ Applies to not-for-profit organizations.
☐ Effective for financial statements for years beginning after June 15, 1994. Earlier application is encouraged in fiscal years for which financial statements have not previously been issued.

No. 93-6 (November 1993), *Employers' Accounting for Employee Stock Ownership Plans*
☐ Supersedes SOP 76-3, *Accounting Practices for Certain Employee Stock Ownership Plans*, and affects certain FASB Emerging Issues Task Force consensuses.
☐ Provides guidance on employers' accounting for employee stock ownership plans (ESOPs).
☐ Contains disclosure requirements for all employers with ESOPs, including those that account for ESOP shares under the grandfathering provisions.
☐ Effective for fiscal years beginning after December 15, 1993. Earlier application is permitted.

Statements on Standards for Attestation Engagements

No. 3 (December 1993), *Compliance Attestation*
☐ Provides guidance for engagements related to management's written assertion about either:
1) An entity's compliance with requirements of specified laws, regulations, rules, contracts, or grants or;
2) The effectiveness of an entity's internal control structure over compliance with specified requirements.

☐ Effective for engagements in which management's assertion is as of, or for a period ending, June 15, 1994, or thereafter. Earlier application is encouraged.
☐ EXCEPTION: Effective for engagements to perform agreed-upon procedures to test a financial institution's compliance with specified safety and soundness laws in accordance with the Federal Deposit Insurance Corporation Improvement Act of 1991, this Statement should be implemented when management's assertion is as of, or for a period ending, December 31, 1993, or thereafter.

Your Voice in Washington

White House Conference on Small Business offers CPAs opportunity to be heard

CPAs have an opportunity to add their voices to the national debate on issues that are important to small businesses by participating in the White House Conference on Small Business.

Delegates to the one-day state conferences, which began in June and will continue through April 1995, will identify issues and develop recommendations for government action. Many of these topics are important to CPAs and their clients.

The topics include a variety of tax issues (fiscal-year conformity, capital gains tax, corporate and individual tax rates, employee/independent contractor classification, payroll tax reform, and subchapter S corporations, to name a few), as well as issues related to federal regulation and paperwork requirements, capital formation, community development, federal procurement, and international trade. State delegates will also elect delegates to attend the national conference in Washington, D.C. in June 1995.

A list of state meetings is available from local U.S. Small Business Administration offices or by calling the AICPA's automated FAX retrieval service, (201) 938-3787 and selecting document no. 520.

AICPA seeks practitioner comments on electronic filing

The Internal Revenue Service expects it will require most returns to be filed electronically by the year 2000, and the American Institute of CPAs wants to ensure that the accounting profession has a say in how this plan is implemented. Accordingly, the AICPA tax division is seeking practitioner input on electronic and other alternative methods of filing tax returns, including scannable forms. Your comments will help the Institute establish a constructive dialogue with the IRS.

Margaret Milner Richardson, IRS commissioner, said at the spring tax division meeting that the IRS is convinced that electronic filing and related technological developments will improve filing efficiency, make account information more readily accessible for taxpayer assistance and compliance purposes, and reduce errors. This year, the error rate on electronically filed returns was 5 percent, compared with the usual 15–17 percent for paper returns.

The AICPA tax division urges you to send comments **before September 12** to the chair of its electronic-filing working group. Mail to: Lloyd Strickland, Strickland & Co., 4144 Carmichael Road, Montgomery, Alabama 36106.

Conference Calendar

National Governmental Accounting and Auditing Update
August 15–16—The Washington Renaissance Hotel, Washington, DC
September 22–23—The Buttes Resort, Tempe, AZ
Recommended CPE credit: 16 hours

Small Firm Conference*
August 17–19—Sheraton Seattle, Seattle, WA
November 9–11—New Orleans Marriott, New Orleans, LA
Recommended CPE credit: Up to 28 hours

National Conference on Savings Institutions*
September 7–9—JW Marriott, Washington, DC
Recommended CPE credit: 21 hours

Public Relations Conference*
September 28–30—The Palmer House Hilton, Chicago, IL
Recommended CPE credit: 18 hours

Practice Management/Marketing*
October 3–5—The Westin Peachtree Plaza, Atlanta, GA
Recommended CPE credit: Up to 27 hours

National Advanced Litigation Services Conference
October 20–21—The Pointe Hilton at Tapatio Cliffs, Phoenix, AZ
Recommended CPE credit: 16 hours

National Conference on Federal Taxes
October 31–November 1—Grand Hyatt, Washington, DC
Recommended CPE credit: 16 hours

National Auto Dealership Conference
October 31–November 1—Flamingo Hilton, Las Vegas, NV
Recommended CPE credit: 16 hours

National Governmental Training Program
October 31–November 2—Hyatt Regency, New Orleans, LA
Recommended CPE credit: 24 hours

National Conference on Banking*
November 3–4—Grand Hyatt, Washington, DC
Recommended CPE credit: 16 hours

Credit Unions Conference
November 7–8—Sheraton New Orleans, New Orleans, LA
Recommended CPE credit: Up to 21 hours

To register, or for more information, call the AICPA CPE division, (800) 862-4272.

*For more information, call the AICPA meetings and travel department, (201) 938-3232.

PCPS CONFERENCE COMPUTER SURVEY

One hundred thirty-seven registrants at the private companies practice section (PCPS) conference, which was held at Bal Harbour, Florida, in May, participated in a survey indicating the types of of computer software used in their firms. Following are the results.

Operating Environment

DOS	129
Windows	69
Unix	9
DR-DOS	2
Apple	1
Other	2

Network

Novell	89
LANtastic	15
Unix	2
Apple	1

Tax Processing

ProSystem fx	52
Lacerte	27
Prentice-Hall	10
SCS/Compute	8
CLR/Fast Tax	7
A-Plus	6
1040 Solutions	4
CPAs	4
Turbo Tax Pro	3
All Others	26

Tax Planning

BNA	76
Lexis	8
CCH	3
All Others	19

Electronic Tax Research

CCH	49
RIA	49
BNA	4
Lexis	2
Kleinrock	2
All Others	5

Trial Balance

ATB	53
Fast!	41
ACE	12
All Others	15

Accounting/General Ledger

MAS 90	26
AccPac	22
One-Write Plus	22
Quickbooks	20
Creative Solutions	17
Great Plains	12
Prentice Hall	11
Peachtree	10
Real World	10
Solomon	6
CYMA	5
CPAs	5
Platinum	4
Unilink	4
Open Systems	2
All Others	23

Spreadsheet

Lotus 1-2-3 for DOS	100
Lotus 1-2-3 for Windows	39
Microsoft Excel for Windows	25
Quattro Pro for DOS	15
Quattro Pro for Windows	7
All Others	3

Word Processing

WordPerfect for DOS	91
WordPerfect for Windows	33
Microsoft Word for Windows	17
Lotus AmiPro	11
Microsoft Word for DOS	8
Wordstar	5
All Others	9

Database

dBase	39
Paradox	10
FoxPro	8
R:Base	7
Q&A	3
All Others	9

Success in Negotiating

People often think of negotiation in terms of strategies and tactics used to outwit another person or to gain concessions. This is manipulation and should be avoided because, in the long run, it will hurt your reputation, credibility, and the outcome of your negotiation.

Negotiation is best described as a collaborative process by which two or more parties try to solve problems for mutual gain. Because their needs are often different, they can often negotiate a much better deal than either had anticipated.

The first step to good negotiation, and possibly the most important one, is to decide on the medium of communication. For example, the negotiation could take place at a face-to-face meeting of two people or a group, or could be conducted by letter, telex, audio tape, video tape, or via the telephone. More than one medium may be used in the same negotiation, but it is all too easy to use the right medium at the wrong time.

A commitment made over the telephone is seldom as strong as one made at a face-to-face meeting. So telephone conversations should always be confirmed immediately with a well-crafted letter, both FAXed and mailed. A letter has the advantage of letting you compose your thoughts uninterrupted by the other party, and its contents are more likely to receive the other party's undivided attention than when two people are conversing.

We gain leverage in a negotiation through our reputation, credibility, the level of trust we inspire, and our flexibility. Ninety percent of the success of a negotiation is determined by the preparation prior to its starting. So, prepare an outline of what you will cover (who, what, why, when, and where) and a fall-back position in case this is needed. Ten percent of the success of a negotiation comes from nonverbal communication—seeing, hearing, and sensing what others are missing.

As you approach a negotiation, remember that your purpose is to satisfy the needs of the other party. Think about the limits on the other participants, how decisions are made in that organization, and about their organizational and personal agendas. You will also need to know if there are any hidden agendas, and must be prepared to ask questions and listen carefully to the responses to find out.

The best way to negotiate with another party is through a collaborative process that builds long-term relationships. With this approach, both parties can work toward creating more value for the other. To do this, think about what the other side really wants from the negotiations and how you can help to obtain it. Think of the process as one of creating viable options.

Tactics

Rehearse with role-playing. Role-play the coming negotiations with members of your firm. Assume both roles—first one side's, then the other's. This will increase your awareness of differences of opinion and expose any weaknesses in your presentation and materials. And keep in mind that most of us don't do something well the first time we do it. Role-playing will hone your negotiating skills.

Consider a third party. There are times when involving a third party might be advantageous, and, certainly, a third-party endorsement of your capabilities can add to your negotiating power. Don't try to solve a problem immediately. Give an overview of the situation and show how you mutually need each other. Learn from your failures and successes and remember that how you close will set the tone for the next meeting.

Attitude is key. Approach the coming negotiations with high expectations because of the preparations you have made. Think of the entire process as one having a short opening and a short closing. These are the two most important times and you want to be scripted for them. Focus on your strengths, not your limitations. And don't be concerned about other people's power.

Good negotiators are often charming people who are courteous and respectful of the other party in a negotiation. Humor and a smile can do a lot to set the mood. Have fun when you negotiate. ✓

—by **Somers White**, *Somers White Company, 4736 North 44th Street, Phoenix, Arizona 85018-3897, tel. (602) 952-9292, FAX (602) 840-5970*

How to Make Better Decisions

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In addition to positive or negative frames, there exists the timing frame. Individuals tend to value gains in the near future more than equivalent gains in the distant future and vice versa. The result is that we tend to work for short-term gains and the quick fix, rather than develop better strategies for the longer term.

You must have noticed in your firm how people tend to adopt a constant frame. Some individuals will always frame things negatively, while someone else will always put a positive spin on even the worst disaster. Over time, when someone uses a constant frame, others in the group may screen the information out entirely because, subconsciously, they realize the bias. The timing frame explains the tendency I see for most CPA firms to seek immediate results, be more apt to draw out all their profits, and

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be less likely to invest in their long-term potential through a fixed research and development budget.

Nonrational commitment refers to our tendency to stick with a course of action even when it is proving unsuccessful and there is little prospect for improvement.

The degree to which people will stay with a course of action even when the situation suggests radical change is in order is known as unilateral escalation. At this stage, subsequent decisions are made to justify the initial choice. If the element of competition is added, escalation increases still further. Now the person will also lose face by substantially changing or reversing course.

This explains why so many CPA firms, and corporations in general, are simply replacing their management personnel. They are finding that those currently in control are unable, or unwilling, to change with the times.

Conclusion

Our decision-making processes were developed at a period in our evolution when there was little information available. Today, through computers and communication technology, information is readily available at comparatively low cost. That, coupled with the development of better ways to manage people and organizations, should ultimately lead to more sound decisions. All you have to do is take advantage of these scientific advances. That, however, may require you to give up some of your biases.

—by **Timothy J. Beauchemin, CPA**, *Enterprise 2000, 1600 Smith, Suite 4900, Houston, Texas 77002, tel. (713) 951-7300, FAX (713) 951-7299, Internet network-@sam.neosoft.com Cserve- 74364,1120*

Editor's note: Readers may wish to refer to Mr. Beauchemin's previous articles dealing with obtaining and using helpful information. See "Getting on the Information Superhighway" (the Practicing CPA, *June 1994) and "Avoiding the Random Walk" (the* Practicing CPA, *March 1992).*